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SUBJECT: AMBASSADOR'S PARTNERSHIP FOR GROWTH: ITALY'S ECONOMIC CHALLENGES AND THE U.S. EXPERIENCE

Summary and Introduction

¶1. Italy has proven to be the best U.S. ally in continental Europe in this young millennium. Unfortunately, since 2000, Italy's economy has grown at an anemic annual rate of only 0.75 percent. To promote economic dynamism in Italy that will produce the resources for Italy to continue to join the United States in confronting future world challenges, the Ambassador has launched his "Partnership for Growth."

¶2. As a preliminary step, the Embassy and a leading Italian socio-economic think-tank, CENSIS, co-hosted a brainstorming session January 30. Dubbed "Italy's Economic challenges and the U.S. Experience," the day-long session brought together Italian owners of small and medium enterprises (SMEs), representatives from larger U.S. (e.g., Microsoft) and Italian (e.g., Lottomatica) corporations, bankers, government officials, academics, and the Italian American Chamber of Commerce. Participants described Italy as an economy with entrepreneurial dynamism (a leader in the EU in annual start-up firms per capita), but also as a "survival economy" with owners just trying to keep their businesses afloat. Bigger companies are seen as part of the social welfare system and are expected to maintain a stable level of employment. Red tape and lack of a sophisticated risk-capital market make it very difficult for Italian SMEs to innovate and grow. Italian entrepreneurs see the need for "creative destruction" (i.e., closing non-viable companies to free resources for new enterprises), and mergers among SMEs to become more efficient and globally competitive. Greater university-private sector cooperation would foster innovation and growth in Italy.

¶3. As part of the Partnership for Growth, the Embassy will cooperate with Italy in broadening and deepening capital markets, especially access to risk capital. We also will advance private sector-university cooperation and partnership in Italy, in particular by supporting and assisting the GOI with implementation of an Italian "Bayh-Dole Act". End Summary and Introduction.

A "Survival Economy" with "One Thousand Obstacles"

¶4. Censis director Giuseppe Roma characterized the Italian economy as "dynamic" but at the same time a "survival economy" burdened by "one thousand obstacles." Roma maintained that, partially due to the cultural and economic environment, Italian entrepreneurs focus more on survival than growth. Roma indicated that while Italy exceeds the EU average in new businesses per capita created annually, with very rare exceptions, these ventures remain small. Participants largely concurred with Roma and identified as key obstacles: high taxation, inflexible labor laws, inadequately trained personnel, and lack of a sophisticated risk capital market.

Industry's Duty to Employ

¶5. Italian participants argued that big businesses (industries) in Italy serve a social function. Once created "the system" expects the enterprise to remain in business forever, becoming a "lifelong" provider of employment. While the government has provided some public funding and incentives aimed at protecting jobs (along with a "certain degree of tolerance" by authorities on tax reporting), participants argued that the system on balance hurt business. High labor costs and "jobs for life" (it is nearly impossible to fire an employee in entities with more than 15 employees) are disincentives to new business opportunities and to grow and "stick one's neck out." High fixed labor costs drain capital that would otherwise go to buying technology that would increase productivity, the consequence being an absence of a culture of innovation and growth.

"Inward" Internationalization

¶6. Some participants said they had moved production to Eastern Europe, where the cost of labor is substantially lower. However, they openly admitted that such moves may be short-sighted measures meant simply to preserve their existing share of the Italian market, rather than aimed at entering and growing in foreign markets. One participant proposed that U.S. firms interested in Eastern European market team up with Italian companies already there, which would allow Italian companies a growth opportunity, and would allow U.S. firms to team up with a "western" partner in difficult markets.

Small Is Ugly

¶7. All participants agreed that it is no longer possible for Italian business to remain small and survive. Consolidation and growth is a necessity. The next generations of entrepreneurs have come to terms with the need to cooperate and aggregate and turn over management of enterprises to professionals. However, Italy must find ways to accelerate this process. Not only do Italian entrepreneurs feel the need to merge and grow domestically, but it has become apparent to most that expansion in emerging markets will only be possible by teaming up with foreign partners.

Risk Capital a Missing Ingredient

¶8. Lack of a sophisticated, diversified risk capital market is a key concern of Italian businesses. Participants unanimously sought U.S. collaboration. While press headlines are grabbed by big, cross boarder bank mergers, SMEs want a more direct, "personalized," financing option. Businesses call for "tailored" risk capital typical of U.S. seed and venture capital, and private equity markets. Participants saw a catch 22 in which the absence of Italian risk takers has made the Italian market unattractive for those who offer risk capital. At the same time, absence of risk capital has not enabled potential risk takers to pursue their visions.

Private Sector- University Collaboration

¶9. Participants also bemoaned the lack of a developed and structural collaboration between universities and the private sector. Examples of successful isolated projects were provided, but participants cited the need for a legal framework providing a more dynamic and institutionalized collaboration. In particular, the representative from the Ministry of Productive Activities (somewhat comparable to the U.S. Department of Commerce) underscored that Italy (in collaboration with the Embassy and the U. S. Patent and Trade Office) has drafted an Italian version of the Bayh-Dole act. Participants identified the need for such legislation, which would provide clear property rights to university research and specific benefits to spin-offs resulting from the research.

University Excellence

¶10. Some participants argued that a related question is that concerning the legal value of university degrees, as in Italy competition for public sector employment is based solely on formal titles and not personal standing. A university title legally is a fungible commodity (for the purpose of public administration employment, not the private sector). It is comparable to a driver's license -- it doesn't matter where it was issued. This has the perverse effect of eliminating competition among universities for better students/professors and diminishing universities' drive to innovate.

¶11. Universities, mostly state-run and low-cost, serve as a social "parking lot" for young people. Students have little incentive to graduate on time and often linger until their late twenties to avoid the lack of opportunities in the "real world." Experts, including former EU Commissioner for Competition Mario Monti, believe that eliminating the legal value of degrees will serve as catalyst to move Italy from a "bourbonist" higher education system, to one where excellence, innovation, research, and cooperation with private sector will become the driving force leading to an overall cultural change in Italian economic thinking.

Next Steps

¶12. While we cannot address all the challenges in the Italian system, we should engage in the areas of risk-capital markets and university-private sector collaboration. Within the framework of the Ambassador's Partnership for Growth we will share the U.S. experience in risk capital by

bringing U.S. experts and practitioners to Italy. Similarly, we will work with Italy to promote innovation and collaboration between private sector and academia. We think that, building on a 2003 bilateral declaration and subsequent bilateral collaboration, a key first step is to work with the GOI towards enactment of an Italian Bayh-Dole as early as possible in the new legislature (general election to be held in April). Allowing a legal framework for such collaboration will have the effect of stimulating new initiatives and research collaborations. We plan to begin this initiative with a meeting of key Italian university presidents in March.

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